

Economics in Management Practice

Sample

MBA (Executive) Program

AGSM MBA Programs

Sample

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Economics in Management Practice

Course overview

Sample

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Sample

Session 1, 2009 Calendar

Economics in Management Practice Graduate Diploma in Management (GDM)

Week no.	Week begins	Unit	Assessment due (% weighting)
1 (Intro)		1	
2		2	
3		3	
4		4	
5		5	
6		6	
Mid Session Exam (25%)			
7		7	
8		8	
9		9	
Break Week			
10		10	Group Assignment (30%)
Workshop 1			
11		11	
12		12	
Final Exam (45%)			

Course outline

When you think of what an economist does, you probably think about interest rates, unemployment, exchange rates and economic growth. These are indeed things economists are interested in. You probably don't think though that economists can help you improve your understanding of your day-to-day business. There are many tools that can help you improve your decision-making in business. That's why we've called this course *Economics in Management Practice* – it's all about how using the 'economic way of thinking' can help you:

- understand your market;
- make better decisions;
- understand the decisions that others in your market have taken;
- respond to those decisions in the best way possible;
- appraise the economy as a whole; and
- understand how factors in the macroeconomy affect consumers and firms.

Economics is a very wide discipline, so in this course we will concentrate on those aspects that most affect managers. We commence with microeconomics (including supply, demand, market structures and costs) then move into some more contemporary areas of study (including game theory, principal-agent problems and outsourcing). We will conclude the course by looking at macroeconomics (including economic growth, price growth, the money system, inflation, monetary policy and fiscal policy).

So what is this 'economic way of thinking' that we mentioned before? It involves a few key principles – that any decision involves trade-offs (which we refer to as opportunity costs), that individuals make decisions at the margin (they look at the increase in the benefit they receive from consuming or producing one more unit of a good or service) and that freely operating markets are the best way to achieve efficient allocation of resources (getting the highest possible level of benefit out of the resources available). The other crucial component of the economic way of thinking is that we can understand the economic world around us more easily if we create economic models of the way that world works – models are just simplifications of the highly complex interactions that take place in real-world economies. These models allow us to study the crucial aspects of how decisions are made (for example, how much of which goods to consume or produce, which resources or inputs to use, how to appraise the economy as a whole) without getting bogged down in too much detail. We cover a general introduction to these topics in Unit 1.

In Unit 2 we apply the core elements of our economic way of thinking to the two most fundamental components of market interaction – demand and supply. If you’ve ever heard economists talking about the usual increase in petrol prices over a holiday weekend, you probably heard them say ‘It’s just the law of supply and demand – it’s nothing sinister’. What they mean is that if the demand for something increases, then in general the price of that good will rise. Alternatively, if the OPEC nations decide to increase the supply of oil to the market, this is likely to lead to a decrease in the price of oil.

Any economic activity involves costs. For example, to produce a tonne of steel, certain inputs are required and these inputs cost money to buy. The same applies to the provision of services, where we incur costs such as salaries. We are quite familiar with accounting for the costs of inputs such as iron ore, coal and labour. However, there are other costs that we might want to consider – costs that sometimes aren’t always easy to put a dollar figure to. In Unit 3, we explore how economists view costs and how firms can use these concepts to make decisions about which goods and services to produce and how much of these goods and service to produce.

Buying and selling of goods and services takes place in markets. We will consider several market structures in this course and in Unit 4 we turn our attention to the first of these – the perfectly competitive market. These are markets in which there are many buyers and many sellers, in fact, so many that no single buyer or seller has any ability to influence price or other conditions. In reality there are but a few markets that fall into this category, so this begs the question of why ‘practical’ managers, such as you, would need to study them. The answer is that this market structure is our efficiency benchmark – it is the type of market that leads to the most efficient allocation of resources. It is therefore a foundation for deciding how to regulate industries and to increase overall social efficiency.

Unit 5 deals with the opposite extreme of market structures – monopolies. In these markets there are still many buyers but only one seller. Because this seller stands alone, it has market power and it is likely to make more profit than if it were operating in competition with lots of firms supplying the same good or service. That’s why a company like Telstra is subject to government regulation – to prevent them from exploiting their monopoly position in the infrastructure of telephony services. In Unit 5 we also consider a third type of market structure – monopolistic competition. In this market there are many buyers and many sellers who offer similar, but not identical products. By differentiating their products, sellers can operate like monopolists in the short run to gain additional profits, but their market power is then eroded by the actions of their competitors in the long run.

In some markets, there is more than one firm, but fewer than many – these markets are called oligopolies. Our usual models of demand and supply won't help us much in analysing the behaviour of firms in this type of market – we need to develop some other tools to help us. In Unit 6 we develop an understanding of how game theory can help us analyse markets in which firms are interdependent, when one firm's profit depends on the actions of other firms in the market. For example, game theory can help us understand how other firms respond when one firm decreases the price of one of its products and what the consequences of these responses are for each firm's profits.

So far, we've only talked about things external to the firm. In Units 7 and 8 we look inside the 'black box' that the firm has so far represented. If you've taken *Corporate Finance*, you may have heard of agency theory. In Unit 7, we develop an understanding of how principal-agent problems (the subject of agency theory), affect the efficiency of outcomes in individual decision-making. For example, if you hide an illness from your medical insurer, you might be creating a situation of adverse selection or moral hazard, which means that the rate the insurance company charges you may not be as high as it should given your illness. In Unit 8 we look at decisions such as whether to expand or narrow the boundaries of a firm. This is what economists refer to as 'Make or Buy' decisioning. You may already know some related terms such as outsourcing and vertical integration.

At this stage in the course we will turn our consideration to the economy as a whole – the big picture. We begin in Unit 9 by explaining what some of the key issues are in the macroeconomy, using terms that you've probably heard everyday in the news. We describe some of the key measures we use to take the temperature of the economy, such as gross domestic product (GDP) and the consumer price index (CPI). We also define the GDP price deflator, which will help us distinguish between nominal and real GDP growth – the first includes the effects of inflation, the second doesn't. We then look at long-term goals for the macroeconomy, such as growth and productivity, as well as short-term goals, such as inflation stability and see what the links are between the long run and short run.

In Unit 10, we examine savings, investment, the monetary system and inflation. Every month when the Reserve Bank Board meets, many mortgage holders wait with baited breath to see whether or not interest rates will rise. But why does the Reserve Bank alter interest rates in the first place and how does altering interest rates affect the economy as a whole? We look at why interest rates are so important and how the relationship between money and interest rates can have an affect on savings, investment, growth and inflation.

In Unit 11 we consider open economies. These are countries such as Australia that interact freely with other countries around the world. In an open economy we need to consider elements such as exports, imports, capital flows and exchange rates. In this unit we will also develop the last of our economic models – the aggregate supply and aggregate demand model. We use this model to study short run fluctuations in the economy – the Business Cycle. We will also consider the impact of both monetary policy and fiscal policy on the macroeconomy.

To finish the course we use Unit 12 to debate some key aspects of macroeconomic policy and to review the course in preparation for the exam.

The EMP Facilitators trust that you will find the ‘economic way of thinking’ to be a very useful addition to your business managers’ toolbox. We hope you enjoy our course.

AGSM MBA Programs contact details

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If you have any administrative queries, they should be addressed to Academic Affairs.

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Assessment

Summary of requirements

In order to pass this course, you must:

- Achieve an aggregate (overall) mark of at least 50, and
- Achieve a minimum pass grade in the final piece of assessment.

Assessment 1 – Mid session exam

Date:
Weight: 25%
Duration: One and a half (1.5) hours

Assessment 2 – Group assignment

Due: Week 10
Weight: 30%
Maximum Length: 8 pages

Assessment 3 – Final exam

Date:
Weight: 45%
Duration: Three (3) hours

Assessment criteria

Unless otherwise specified, the following criteria will be applied in assessing your written work:

- attention to the primary focus of the exercise or assessment
- evidence of a clear understanding of the economic concepts used
- quality of the application of economic theory to problems
- clarity of thought and logically structured argument
- application of a well-rounded analytical approach to the exercise or assessment
- evidence of adequate background reading where relevant
- quality of presentation in terms of grammar and spelling.

Assessment 1 – Mid Session Exam

Due:

Weight: 25%

Duration: One and a Half (1.5) hours

The mid session exam will cover material from Units 1 to 4 inclusive. The format of the exam includes both multiple choice and short answer questions.

Assessment 2 – Group assignment

Due: Week 10

Weight: 30%

Maximum Length: 8 pages (Submitted in accordance with the formatting rules on the following pages)

Page size		A4
Page margins	Top:	3.5 cm
	Bottom:	2 cm
	Left:	3.17 cm
	Right:	3.17 cm
	Gutter:	0 cm
Font		Arial
Font size		12 point
Text style		Normal
Line spacing		1.5 lines
Headings [You are encourage to use headings to outline the structure of your document]	Level 1:	14 point font size and in bold
	Level 2:	12 point font size and in bold
Diagrams and Graphs		You may utilise a font size of no less than 10 point for diagrams and/or graphs. All diagrams and/or graphs must still be clear, proportional and easily readable
Tables		Tables are considered to be text and therefore require the same format as text (e.g. 12 point font size, 1.5 line spacing, etc). Also consider that the use of tables might disrupt the overall structure of the document and weaken the logical flow of your economic argument(s).
Header		1 cm from edge. Use 10 point font size. Header on each page is to show 'EMP Assessment No.2' on the left-hand side and the student names on the right-hand side (names are to be listed vertically one under the other and in alphabetical order)
Footer		1 cm from edge. Use 10 point font size. Footer on each page is to show the date of submission of the assessment on the left-hand side and the sequential page number on the right-hand side
Footnotes [Footnotes may not necessarily be required in your document]		Use 10 point font size. Footnotes are to be inserted at bottom of the relevant page only. Numbering is to be sequential throughout document

Assessment 2 is a group assignment. You will be provided with the assessment question later in the term.

Each assessment group is to consist of **no more than 5 students**. A group may **only be formed between students who have the same EMP Instructor**.

Assessment 2 will be graded in accordance with Standards-based guidelines. These guidelines are shown below.

Presentation & Style	Criteria	'HD' & 'DN' range	'CR' range	'PS' range	'FL' range
	CONFORMING WITH INSTRUCTIONS [also refer to Note 1]	Assessment is presented in exactly the stipulated format.	Assessment is presented with slight deviations from the stipulated format.	Assessment is presented with noticeable deviations from the stipulated format.	Assessment is presented with significant deviations from the stipulated format.
	CLARITY OF EXPRESSION (including spelling, grammar, punctuation)	Fluent writing style that presents and analyses ideas concisely and effectively in a structured manner. Language is very clear and the meaning is easily apparent. Correct grammar, spelling and punctuation.	Mostly fluent writing style that presents and analyses ideas concisely and effectively but in a less structured manner. Language is clear and the meaning is generally apparent throughout. Grammar, spelling and/or punctuation have minor shortfalls.	Generally fluent writing style that presents and analyses ideas less concisely or less effectively and in a less structured manner. Language is sometimes unclear and the meaning is sometimes not apparent. Grammar, spelling and/or punctuation have shortfalls.	Writing style is not fluent or does not present or analyse ideas concisely and effectively. The text is unstructured. Language is quite unclear and the meaning is often hard to determine. Noticeable shortfalls in grammar, spelling and/or punctuation. The document lacks attention to detail.
	REFERENCING	Referencing is both correct and complete.	Referencing is generally correct and complete.	Referencing has some shortfalls in either correctness or completeness.	Referencing is absent or of a poor standard.

Note 1: Late submissions will be penalised 5% per day or part thereof. If the page limit is exceeded then the piece of work shall be assessed from the first page up to and including the page on which the page limit is reached. Pages beyond the page limit will not be read by the marker.

Participation	Criteria	'HD' & 'DN' range	'CR' range	'PS' range	'FL' range
	GROUP EFFORT	The whole assessment presents strongly as coherent and coordinated piece of work. There is no evidence of, say, some group members doing just one part of the assignment and not assisting with any other part.	The assessment presents as coherent and coordinated piece of work, but with some shortfalls. For example the answers to different parts may have a different 'tone & feel' indicating work splitting across the group.	The assessment is somewhat coherent and coordinated but has some noticeable lapses. For example there may be a disjointed style throughout the documents arising from students 'cutting & pasting' individual pieces of work into one document.	The assessment presents as a non-coherent document. It appears to be an uncoordinated 'cut & paste' of paragraphs written by several authors.

	Criteria	'HD' & 'DN' range	'CR' range	'PS' range	'FL' range
Content	RANGE AND UNDERSTANDING	<p>Comprehensive understanding of the depth, width and breadth of the topic and the theory through which to analyse it.</p> <p>Shows evidence of solid appropriate research.</p> <p>Appraises a full set of different options, has significant original content, is lateral and adopts a wide array of perspectives.</p>	<p>Sound understanding of the depth, width and breadth of the topic and the theory through which to analyse it .</p> <p>Shows evidence of some appropriate research.</p> <p>Appraises different options, has original content, is somewhat lateral and adopts a good variety of perspectives.</p>	<p>Limited understanding of the depth, width and breadth of the topic or the theory through which to analyse it.</p> <p>Relies on only information that is easily obtained.</p> <p>Appraises only a few different options and is uninspiring in regard to original content and lateral thought. Adopts a limited variety of perspectives.</p>	<p>Lacks understanding of the topic or the theory through which to analyse it.</p> <p>Conducts no research or uses of irrelevant information sources.</p> <p>Appraises only the most obvious options. Has very little lateral or original content. Adopts the most basic perspective.</p>
	ECONOMIC WAY OF THINKING	<p>Consistently demonstrates application of critical reasoning and the 'economic way of thinking'.</p>	<p>Demonstrates good application of critical reasoning and the 'economic way of thinking'.</p>	<p>Demonstrates some application of critical reasoning and the 'economic way of thinking'.</p>	<p>Does not demonstrate application of critical reasoning, nor display an 'economic way of thinking'.</p>
	APPRAISING AND ANSWERING THE QUESTION THROUGH AN ANALYTICAL APPROACH	<p>Displays a high level of logical analysis.</p> <p>Does not simply 'describe facts', but rather is 'analytical' in approach. Convinces the reader of the point at hand.</p> <p>Answers the question fully.</p> <p>Debates points very well and with confidence.</p> <p>Draws well supported conclusions (i.e. demonstrates reasons for final decision).</p>	<p>Displays a good level of logical analysis.</p> <p>Is sometimes 'descriptive' rather than being 'analytical' in approach.</p> <p>Answers the question well.</p> <p>Good debate of points is evident.</p> <p>Draws conclusions and provides some support to those conclusions (i.e. shows that selection of final decision follows from the analysis).</p>	<p>Displays a basic level of logical analysis.</p> <p>Is quite 'descriptive' rather than being 'analytical' in approach. Tells the reader a 'story' instead of convincing the reader with a line of argument.</p> <p>Answers the question simplistically.</p> <p>Relatively weak debate of points.</p> <p>Draws only obvious conclusions (i.e. presents benefits and disadvantages but does not clearly reason the final conclusion).</p>	<p>Displays illogical analysis.</p> <p>Presents a standard 'book review' and does not offer analysis.</p> <p>Does not answer the question.</p> <p>Does not debate points.</p> <p>Either draws unsupported conclusions (i.e. little or no explanation of how the final conclusion was reached), or draws no conclusions at all.</p>

Assessment 3 – Final exam

Date:

Weight: 45%

Duration: Three (3) hours

The final exam will cover material from the entire course. The format of the exam is both multiple choice and short answer questions. The sample exam included in these course notes indicates the format and style of questions.

Sample

Learning resources

We have put together several resources to help you improve your understanding of economic concepts and gain the ‘economic way of thinking’. Your basic resource will be the textbook *Principles of Economics* (3rd Edition) by Gans, King, Stonecash and Mankiw. Please note that any reference in these Course Notes to a textbook chapter, page and/or exercise will align with the 3rd Edition of the textbook. The only topics not covered fully in the text are those found in Units 6, 7 and 8; which move into fields of more contemporary business economics. For this reason you will notice that Units 6, 7 and 8 in these Course Notes are ‘self-contained’ and have been written specifically for *Economics in Management Practice* at the AGSM.

You will find several exercises within each unit, and answers to these exercises will be progressively distributed to you after the class sessions to which they refer. There are also questions and problems at the end of each chapter of the text. Some of these questions have been transformed into exercises within the unit, but you are still encouraged to expand your understanding by attempting some of the other questions and problems in the text as well.

We have additional readings in some units that are designed to either deepen your understanding of the concepts, or show you some practical applications of the concepts. Your instructor might also provide you with readings from time-to-time from the press of the day – one of the good things about economics is that it’s in the news almost every day!

Another important resource for you is the ‘Aplia’ website created by Professor Paul Romer from Stanford University. This is a great resource for you to use to test your understanding of most of the topics we cover. While studying the unit material you will be able to log onto the website to do a self-test of your understanding. The self-tests are not mandatory. The website also provides immediate feedback and explanations of questions.

Aplia also offers an integrated textbook solution. When you log onto the Aplia website, you will be able to access the AGSM course materials, the textbook and the Aplia questions and answers.

So let’s get started!

Reading list

Unit	Readings	This reading is concerned with ...
1	• Chapter 1	• Introduction to economics
	• Chapter 2	• Introduction to thinking like an economist
2	• Chapter 4	• Supply and demand
	• Chapter 5	• Elasticity
	• Chapter 7	• Consumer surplus, producer surplus and social surplus
3	• Chapter 13	• Costs of production
	• Chapter 19	• Factors of production
4	• Chapter 14	• Perfect Competition
	• Chapter 17	• Competition Policy
5	• Chapter 15	• Monopoly
	• Chapter 18	• Monopolistic Competition
6	• Course Notes	• Game Theory
7	• Course Notes	• Principal-Agent problems
8	• Course Notes	• Firm boundaries ('Make or buy' decisions)
9	• Chapter 24	• Measuring a nation's income
	• Chapter 25	• Measuring the cost of living
	• Chapter 26	• Production and growth
10	• Chapter 27	• Savings and investment
	• Chapter 29	• The monetary system
	• Chapter 30	• Inflation
11	• Chapter 31	• Open economies
	• Chapter 33	• Aggregate demand and aggregate supply
	• Chapter 34	• Monetary Policy and Fiscal Policy
12	• Chapter 36	• A debate over macroeconomic policy

N.B.: There are also additional readings at the end of some units in your Course Notes.

Acknowledgements

Course Co-ordinator

Scott Muller MBA, MSc (Marine Eng), BE (Mechanical)

Scott Muller has been associated with the AGSM since 1996. He facilitates several courses on the MBA (Executive) Program, including: *Economics in Management Practice* and *Corporate Finance*. Scott also teaches on the full-time MBA Program; most notably his specialist elective course on the practical application of Optimisation and Numerical Modelling Techniques in Business and Finance.

Scott holds an Undergraduate Degree in Mechanical Engineering from the University of New South Wales, a Masters Degree in Science from the University of Plymouth (UK) and is a graduate of the full-time AGSM MBA Program. His PhD studies are centred on the economics of large-scale commercial contracts and the associated application of auction theory.

Scott worked for several years as an engineer and senior manager in the maritime industry throughout Australia and South East Asia. He has held two diplomatic positions overseas and has been the lead designer and negotiator for many large commercial contracts. Scott now holds a senior position within the Banking and Finance sector and he also consults across a diverse range of corporations and industry groups.

Course writers

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Appendices

Appendix 1 Sample exam

Appendix 2 Assessment cover sheet

Sample

Sample

Appendix 1

Sample exam

Sample

Sample

AGSM MBA Programs

Economics in Management Practice Final Examination

Name: _____

Instructor: _____

Class: _____

Instructions

1. Time allowed: **3 hours, plus 15 minutes reading time.**
2. The examination is worth **50% of your final mark** for this course.
3. The Exam consists of **two (2) Sections.**
 - Section A consists of 18 multiple-choice questions.
You are required to answer all eighteen (18) questions from this Section.
This Section is worth 20% of this Exam. Each question in this Section is of equal value.
 - Section B consists of four (4) short-answer questions.
You are required to answer all four (4) questions.
This Section is worth 80% of this Exam. Each question in this Section is of equal value.
Marks for the sub-sections within each question are provided in brackets at the end of each sub-section.
4. Answer Section A on the multiple choice answer sheet provided at the end of this question paper. Ensure your name and details are clearly marked on the multiple choice answer sheet.
5. Answer each question in Section B in a separate answer booklet (4 booklets in total). Ensure your name, details and the question number are clearly marked on the front of each answer booklet.
6. This question paper is to be returned at the end of the exam. Ensure your name and details are clearly printed on this question paper.
7. The MBA (Executive) has a policy of open book examinations. You may bring your course materials, your study notes and your calculators into the examination session. Your materials and textbooks may be annotated and the use of Post-it™ Notes is permitted. However you are strongly cautioned against copying the work of others. This is plagiarism and a breach of discipline.
8. Laptop computers and other electronic devices such as mobile telephones are prohibited. Students from non-English speaking backgrounds who have written approval from Academic Affairs may use standard linguistic dictionaries. No other dictionaries are permitted. If you enter the examination session with prohibited material, surrender it immediately to the examination supervisor.
9. Before leaving the examination room, please return this question paper, a completed exam attendance sheet, all your answer booklets and the multiple choice answer sheet.

Section A Multiple Choice Questions

Instructions:

The multiple-choice answer sheet for Section A is attached at the end of this question paper. The answer sheet has numbers and letters listed corresponding to the eighteen (18) questions in Section A.

For each question in Section A, circle the letter corresponding to the answer you believe is most appropriate. Circle only one letter per Question.

For example (this is only an example, and does not necessarily provide the correct answers in this Paper):

1. a b c d
2. a b c d
3. a b c d

Section B Short Answer Questions

Instructions:

You should give as full answers as possible to each Question and sub-section of each question. Ensure you clearly state and explain any assumptions on which your answers rely.

You should show all your working for any numerical calculations. If you demonstrate you have a correct solution process to a problem, even if your final numerical result is incorrect you may receive partial marks.

Section A

Multiple-Choice Questions

Question A1

When we say that all economic goods are scarce, we mean that

- a. very few items of the goods exist
- b. production has not kept pace with other goods
- *c. the goods have opportunity costs
- d. the supply of the goods has decreased

Question A2

An economy is 'efficient' when it

- *a. uses its resources so as to maximise the satisfaction of wants
- b. develops industries to the point of being independent of foreign suppliers
- c. adopts the latest techniques in all lines of production
- d. operates at a level of full employment

Question A3

Which of the following constitute real investment?

- a. purchase of shares through the stock exchange
- b. the buying of a factory completed last year
- *c. the building of a block of apartments
- d. all of the above

Question A4

Which of the following would you regard as the best measure of change in a country's standard of living? Changes in

- a. total real income
- b. total consumers' expenditure
- *c. consumption of goods and services per head
- d. private sector expenditure per head

Question A5

A firm practicing price discrimination will be

- a. charging different prices for different qualities of a product
- *b. charging different prices in different markets for a product
- c. buying in the cheapest and selling in the dearest market
- d. fixing the price at which its goods are retailed

Question A6

A firm's average cost is minimized at 100,000 units of output. The firm has a U-shaped average cost curve. If the firm is observed to have a long-run equilibrium output of 85,000 units then it is

- a. making less than normal profit
- b. making super-normal profit
- c. experiencing decreasing returns to scale
- *d. operating under monopolistic competition

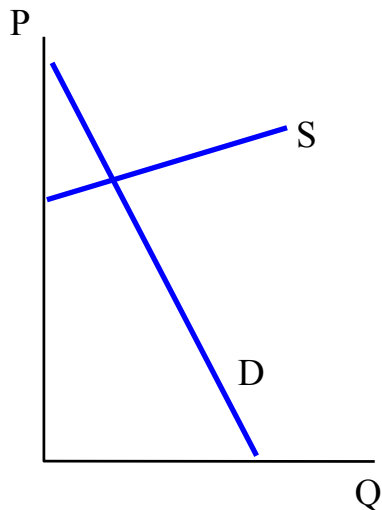
Question A7

The income effect of a rise in the price of a good is the

- a. extent to which the incomes of suppliers increase
- *b. decrease in the purchasing power of a consumer's income
- c. extent to which consumers of substitutes are better off
- d. decrease in the demand for the good

Question A8

Consider the supply and demand diagram shown below for a good in a perfectly competitive market



A universal increase in production costs for all manufacturer's of this good will cause

- a. a move along the supply curve to reflect the higher cost of production
- b. a shift of the supply curve to the right to reflect the higher cost of production
- c. a percentage decrease in quantity demanded at the new equilibrium that is less than the percentage increase in equilibrium price that arises due to the higher cost of production
- *d. a percentage decrease in quantity demanded at the new equilibrium that is greater than the percentage increase in equilibrium price that arise due to the higher cost of production

Question A9

The most thorough description of the conditions of long-run equilibrium for a firm operating under perfect competition is

- a. $MC=MR$
- b. $MC=MR=AR$
- *c. $MC=MR=AR=AC$
- d. none of the above

Question A10

In a market for a normal good, the cost of production rises at the same time that consumers' income falls. Due to these changes, this market will certainly experience

- a. lower equilibrium price

- b. higher equilibrium price
- c. higher equilibrium quantity
- *d. lower equilibrium quantity

Question A11

Consider the following simultaneous-move game where the payoffs represent additional profit for the firms

		JBR			
		LEFT		RIGHT	
SCS	UP	\$12m	\$23m	\$5m	\$23m
	DOWN	\$14m	\$16m	\$7m	\$15m

A stable outcome for this game would occur if

- a. SCS plays 'down' and JBR plays 'right'
- *b. SCS plays 'down' and JBR plays 'left'
- c. SCS plays 'up' and JBR plays either 'left' or 'right'
- d. none of the above

Question A12

Consider the following figures from a country's national accounts

Wages and salaries	\$20,000
Profits and rents	\$6,000
Income from foreign-based assets	\$1,500
Payments to foreigners owning internal assets	\$1,000
Capital depreciation for the year	\$2,500

Gross national product is

- a. \$27,500
- *b. \$26,500
- c. \$25,000
- d. none of the above

Question A13

Consider the following data

Measure	Year X	Year Y
National Income	\$80,000m	\$120,000m
Retail Price Index	100	150
Population	40m	60m

In comparison to Year X, in Year Y the above country

- a. enjoyed a higher standard of living
- b. had a lower real national income
- c. was just as well off
- *d. none of the above

Question A14

Consider the following two statements:

- S1. Measurement of national income at constant prices indicates trends in real national income
 - S2. The constant price technique eliminates fluctuations in national income caused by changes in the value of money
- *a. S1 is correct AND S2 is correct AND S2 is a correct explanation of S1
 - b. S1 is correct AND S2 is correct BUT S2 is not a correct explanation of S1
 - c. S1 is correct AND S2 is incorrect
 - d. S1 is incorrect AND S2 is correct

Question A15

A poor country may find it more difficult than a rich country to achieve any given rate of economic growth because it has

- *a. a smaller average propensity to save
- b. a lower capital to output ratio
- c. a weaker balance of payments
- d. more idle resources

Question A16

When a country saves a large portion of its GDP

- *a. more resources will be available for investment in capital
- b. the country's productivity will fall
- c. the population's standard of living will fall
- d. none of the above

Question A17

Purchasing-power parity describes the force that determine

- a. exchange rates in the short run
- *b. exchange rates in the long run
- c. prices in the short run
- d. prices in the long run

Question A18

Which of the following can be used as a macroeconomic policy instrument?

- a. the sale and purchase of government bonds by the RBA
- b. the collection of tax revenue by the government
- c. the expenditure of tax revenue by the government
- *d. all of the above

Section B

Short-Answer Questions

Question B1

In this question you are asked to consider the market for cosmetic surgery.

- a. What type of market structure is most appropriate to describe this market today? Explain.
[4 marks]

Defining the market boundaries is important here because the most appropriate market structure will depend on each student's assumption of who are the buyers, suppliers and substitutes for cosmetic surgery. For example, students might narrow the market to just Australia, while others take a global consideration. Does the market just include elective surgery (to enhance appearance) or does it also include surgery to repair of trauma or defect. Are the suppliers just cosmetic surgeons in hospitals or do we include simpler day clinics surgeons as well. Do we assume that there are few substitutes for the non-elective patients, but beauty products (and maybe even just a good exercise routine) may be substitutes for elective patients. We further note that some differentiation of product might be achievable in this market via a perception of the quality of output (ex-post and generally by word of mouth).

Herein this possible answer we constrain the market to just elective surgery performed in Australian hospitals by nationally registered professional surgeons. This market is considered to be somewhat competitive.

- b. Discuss the current elasticities of demand and supply in this market.
[4 marks]

- **Own-Price Elasticity of Demand:** We initially think demand in this market might be fairly unresponsive to price (relatively inelastic) since it appears that elective patients will still be willing to pay for the service even if price were to rise significantly. A counter argument can be put for elastic demand as a significant price fall may entice many other customers to enter the market. There are few substitutes which adds to the thought that demand is relatively inelastic. Moreover, we also note that this market sees many 'repeat customers'.
- **Income Elasticity of Demand:** More advanced students will realize the question seeks their comment on income elasticity and cross-price elasticity as well. With regard to Income elasticity, the service is, to many, a luxury good and we might expect a noticeable increase in the fraction of people's budget that is devoted to it if incomes were to rise significantly.
- **Cross-Price Elasticity of Demand:** Cross-price elasticity relates to the most obvious substitutes of anti-aging cosmetics/pharmaceuticals. Since this substitution is weak (some might even argue that they are actually complements to cosmetic surgery) we expect little response to cross-price movements.
- **Supply Elasticity:** We consider that supply would be relatively inelastic (unresponsive to price) due to high barriers to entry (training, equipment

costs, time to establish a client base, insurance, etc). Additionally, there appear to be very little economies of scale available to suppliers here.

- c. Use your business judgment and the supply/demand model of market equilibrium to assess the major factors that you think will influence the supply and demand schedules in this market over the next 5 years. Explain why and how these factors will have an influence. Ensure you clearly state and justify any assumptions you make.

[10 marks]

There is no unique correct answer here. What is sought is an intelligent application of the market equilibrium model with sound assumptions and well-balanced argument. The answers here will depend heavily on the market boundaries set by the student in Part 1 above. Some factors that might be considered are:

Demand

- Shift right – increasing focus on health and beauty.
- Shift right - growing market from the GenY who tend to live for today, not tomorrow.
- Shift right - impact of TV ‘makeover’ shows that glamorize the benefits of cosmetic surgery for ‘average’ people.
- Shift right – perceived risk of surgery falls as it becomes more ‘commoditised’.
- Shift right – aging population growth and fact that life expectancy is increasing. Although some might argue here that the aging population comes from a generation where superannuation saving was not paramount hence they may not have the wealth to spend on cosmetic surgery anyway.
- Shift right – improved medical techniques and drugs make surgery less invasive and recovery times faster. They also mean that more ‘procedures’ are available to choose from too.
- Shift right – continued strong economic growth in Australia.
- Shift right - buyers are becoming more transient (ie: patients travel to doctors rather than the other way around).
- Shift left – growth in ‘alternative’ medicine
- Shift left – increased information channels (eg: internet) make horror stories more public and accessible to potential buyers.

Supply

- Shift right - Improved medical techniques (eg: lasers) reduce the cost of supply.
- Shift right – consolidation of medical practitioners into ‘specialist’ hospitals will reduce cost of supply to each individual surgeon.
- Shift right – Increasing general health may lead to excess supply of doctors (such as GPs) moving to become specialists
- Shift left – increased insurance costs (although this may be tempered by improved medical techniques that can reduce the risk of surgery, hence the insurance risk).
- Shift left – tightening government regulation forces production costs to rise.

- d. Use your analysis to make qualitative forecasts of future levels of sales in this market and associated future pricing trends. Depict both the current market situation and

your expected future market situation on a clearly labeled single supply and demand diagram.

[2 marks]

The answer here is dependent on the answers provided in part 3 above. The students must make a definitive judgment on what will happen to price and quantity at equilibrium in 5 years. Better students will also discuss possible changes in relative elasticity of demand and supply and will also depict this on their graph.

For the market as defined in this possible answer we expect demand to shift right (net) and become more elastic as the services tend towards commodities. Supply would only just shift right (net) as we feel that technological improvements will outweigh rises insurance, etc. We do not envisage any noticeable change to elasticity of supply.

Question B2

In Papua New Guinea (PNG) two firms, 'Kirupim' and 'Lokim', dominate the market for outbound expatriate relocation services. These companies relocate expatriate's household effects from PNG to the expatriate's native country at the end of the expatriate's contracted term. They offer an end-to-end service; whereby the firm packs the household effects into crates then stores the crates in warehouses until either a berth on a ship, or space on a plane becomes available. Only 20% of expatriates chose to relocate their household effects by air. Kirupim also has warehouse leasing costs that are, on average, 18% lower than Lokim.

After converting from Kina (the PNG currency) to dollars, the total annual revenue available in this market is estimated to be \$1million.

Each firm is considering whether or not to undertake an annual advertising campaign costing \$200,000. If neither firm chooses to advertise, then the current market share split of 50:50 would remain, however, if one firm advertises and the other does not, then the firm advertising is expected to capture at least 80% of the market. If both firms advertise then their efforts effectively nullify each other and the market share split would stay as it is today.

- a. Construct a payoff matrix for this game when the two firms make advertising decisions simultaneously. Clearly explain what 'payoffs' you use and why you consider them to be appropriate. What is/are the Nash Equilibrium of the simultaneous-move game? State the assumptions you have applied in your analysis and discuss the effect of relaxing those assumptions.
[7 marks]

We first note that we are not provided any information about the actual cost of delivery, so we cannot truly determine profits here. For this reason we work in revenues as payoffs in the matrix. We will then be able to consider different cost structures and place any necessary caveats on our analysis. We also note that an assumption of roughly equivalent cost structures for each firm is feasible noting the business is fairly simple and it draws production factor costs from competitive markets (eg: labour, transport, storage).

Using revenues in the matrix we determine that:

- If neither firm advertises, then both receive 50% of \$1mil in revenue = \$500k each**

- If both firms advertise, then each receives 50% of \$1mil in revenue less \$200k each for the advertising campaign = \$500k - \$200k = \$300k
- If one firm advertises and the other does not, then the advertising firm receives (at least) 80% of \$1mil in revenue less \$200k for its advertising campaign = \$800k - \$200k = \$600k, whilst the other firm simply receives (at most) 20% of \$1mil in revenue = \$200k

NOTE: Payoffs here indicate revenue, not profit

		Lokim			
		Advertise		Don't Advertise	
Kirupim	Advertise	* \$300k	* \$300k	* \$600k (<i>min</i>)	\$200k (<i>max</i>)
	Don't Advertise	\$200k (<i>max</i>)	* \$600k (<i>min</i>)	\$500k	\$500k

From the above game we deduce that, when using revenues as payoffs, both firms have a dominant strategy to advertise. The Nash Equilibrium is therefore “Advertise, Advertise” generating \$300k in revenue for each firm.

We need now to consider whether this game (and maybe the outcome) will differ if we relax our assumption about the similar cost structures for each firm. In this regard, we are told about warehouse leasing costs in the question, but since these are but one cost of many, we can draw no conclusion from this limited information about total costs or costs at the margin. Students should recognize that a company's decisioning in a simultaneous game is relative to itself - for example, propose Lokim were to advertise, then Kirupim is trying to simultaneously decide whether to also Advertise (revenue = \$300k) or not (revenue = \$200k). This decision has nothing to do with the relative costs between Lokim and Kirupim, hence cost structures will not alter the outcome of this game. Better students will notice that capturing “at least 80%” of the market, giving rise to a minimum revenue stream of \$600, means that irrespective of cost, this outcome must always be better than the alternative.

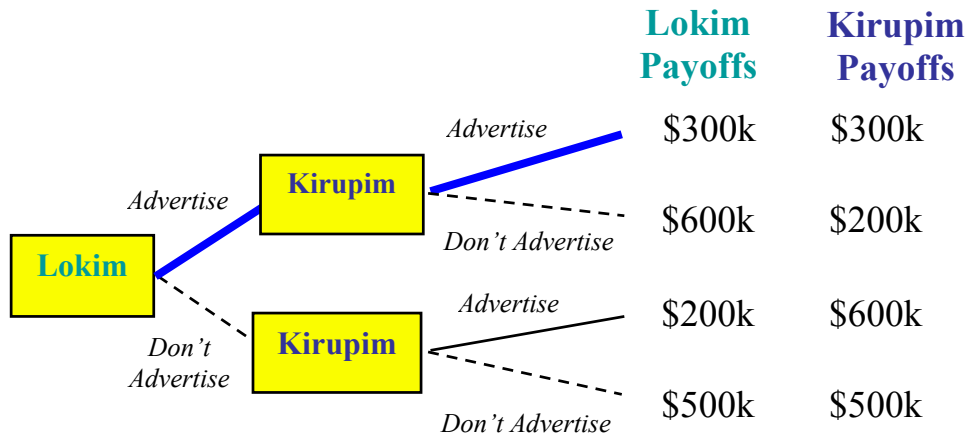
- b. Say that the advertising decision was repeated once every year, but still as a simultaneous move game. Can the firms achieve a better outcome? What is that outcome and what must they do to achieve it and then maintain it? Discuss the sustainability or otherwise of this course of action.
[3 marks]

The game is a Prisoners' Dilemma, so both firms can be made better-off by colluding to not advertise. Students should explain that the collusive position is unstable, and each firm has incentive to default, followed by an incentive for the other firm to also default – thus returning the firms to the stable Nash Equilibrium. Since this is a repeated PD, students must also discuss that a tit-for-tat strategy is needed to govern the collusion.

- c. Can either Lokim or Kirupim gain advantage from being a first mover? Explain.
[3 marks]

No. In short this is because both firms have a dominant strategy to advertise irrespective of the action of the other – hence both will still advertise even in a sequential move game.

The game tree (with Lokim moving first) is shown below. The tree with Kirupim moving first returns the same SPNE as is therefore not drawn here.



- d. The Managing Director of Kirupim has suggested that Kirupim should purchase the sole Advertising firm in PNG in order to gain advantage. He has stated that this will allow Kirupim access to cheaper advertising, whilst also effectively barring Lokim from advertising. How would you advise the Managing Director of Kirupim with respect to this course of action? Explain.
[7 marks]

The MD's suggestion makes little sense. Advertising is certainly not a core competency of Kirupim (whose business it is to project manage removals of household effects). Advertising is also not considered a critical input factor to Kirupim's business (this is observed from the information that, without advertising, the removals market is today split 50/50 anyway). Kirupim does not need to have great flexibility with respect to advertising either; hence it can just buy it from the market when it needs it. There appear to be no confidential information issues either. The transaction costs of buying advertising from the market would also seem comparable (if not less than) the extra control costs that might be necessary if under an integrated model. The only advantage seen in the suggested integration is that since the advertising firm is a monopolist then Kirupim would most likely get access to cheaper advertising. But although barring Lokim from advertising may yield fiscal benefit from Kirupim in the removals market, it is counterproductive for the profitability of the advertising firm itself (ie: they will need to rob Peter to pay Paul).

Question B3

- a. Explain what will happen to the money supply under each of the following circumstances:
[2 marks]

- (i) The public alters its habits and instead of using credit to purchase items, it reverts to using cash.

Here the public decides to hold more currency, and it can only do so by taking reserves out of the banking system. This leaves less money for banks to lend, hence the money supply will fall

- (ii) Banks reserve ratios are lowered.

If reserve ratios are lowered then Banks do not need to hold as much in liquid reserve, hence they will lend more and increase the money multiplier. Money supply will increase.

- b. (i) In general, what conditions in an economy might lead the controller of monetary policy in that economy to increase interest rates?
[3 marks]

Overheating of the economy

- **growth too fast**
- **domestic debt rising too fast**
- **inflation is out of the zone, or high unemployment rates**

- (ii) Suppose the Reserve Bank of Australia (RBA) decides to increase the cash rate next month by 0.5%. What impact will this have on domestic consumption, domestic savings and on domestic investment in the short run?
[3 marks]

Cash rate rises, therefore interest rate rises, hence:

- **consumption falls in short run. Here we note that some households may be committed to a certain consumption pattern in the short run.**
- **as consumption falls, savings will rise**
- **with rise in interest rates we see a fall in investment.**

- (iii) Suppose the increase in the Australian cash rate pushes the Australian interest rate above the US discount rate (the US equivalent to the cash rate). What would happen to the value of the Australian dollar vis-à-vis the US dollar? And explain what you think will be the impact on Australia GDP?
[3 marks]

Rising interest rate brings capital inflows, hence greater demand for AUD. AUD will therefore appreciate against the USD. Higher domestic interest rate will see consumption fall, foreign investment rise (capital inflows), domestic investment fall (in the short run) and net exports fall (because appreciated AUD makes exports more expensive and imports cheaper). Overall effect on GDP is most likely to be a fall.

- c. Discuss the problems the RBA has controlling the money supply in a system of fractional-reserve banking.
[2 marks]

The RBA's control over the cash rate has a powerful effect on the money supply, however, in a system of fractional-reserve banking, the amount in the economy depends in part on behaviour of depositors and bankers. Because the RBA cannot perfectly control and predict this behaviour, it cannot perfectly control the money supply.

- d. Monetary policy and fiscal policy are theoretically separated in Australia. Which body controls which policy area? What instruments are available to each body to control each policy? Discuss the advantages and disadvantages of separating the two policy areas.
[7 marks]

- **Fiscal Policy = Government**

- **Fiscal Policy Instruments = altering government spending & altering the tax system**
- **Monetary policy = RBA**
- **Monetary Policy Instruments = buying and selling of Government Securities in the open market (& possibly altering the fractional reserve ratio)**
- **Advantage of separation is that the RBA can independently concentrate on maintaining a stable (in terms of inflation) economy without the possible impact of political bias (say in an election year). The Government (as an agent of the people) can independently concentrate on low unemployment and growing the economy to improve the quality of life of its constituents. [Note: separation of the policies was also necessary when the AUD was floated].**
- **Disadvantages generally arise from the problem of asymmetric information that is caused by separation of the policies. For example, with asymmetric information the bodies might incorrectly forecast what the other body will do. This can cause their independent policies to either nullify or magnify the intended economic correction. Even with observation of a policy adjustment, there might still be error in predicting the timing and actual impact of the other bodies action [Note that Fiscal policy usually takes a long time to implement via the bureaucracy of government, but it has relatively fast take up once announced. Monetary Policy takes a much shorter time to enact, but it has a longer time to take effect].**

Question B4

- a. Empland is a country in which the labour force totals 100,000. In Empland the unemployment rate is 5%.
- (i) A recent study commissioned by the Empland Government predicts that, over the next few months, 1% of employed workers will lose their jobs each month, and 19% of unemployed persons seeking work will gain employment each month. Explain what this study suggests about the unemployment rate in Empland?
[3 marks]

Since 950 (=0.01 x 100000 x 0.95) employed persons become unemployed each month, and yet 950 (=0.19 x 100000 x (1-0.95)) unemployed persons become employed each month, the study suggests that everything balances out and there will be 5,000 unemployed persons at all times. The unemployment rate will stay at 95%.

- (ii) The Empland Government is keen to reduce the unemployment rate in the lead up to an election next year. Present a macroeconomic argument as to why the Government might wish to do this.
[3 marks]

More employment should increase production and cause economic growth, which in turn should benefit the Government's chance of re-election.

- (iii) To reduce the unemployment rate, the Empland Government is considering a scheme in which they would pay \$200 (tax free) to every employed person per

month. Use supply and demand analysis of the labour market to comment on the Government's proposed scheme.
[4 marks]

The Government is offering a subsidy to employment. We consider a graph of the supply of labour and the demand for labour, where price represents salary [Here we note that some students might draw the market for jobs instead of labour]. The supply curve for labour will shift right because at any wage (ie: any price) people will be more willing to supply their labour due to the extra \$200 they will receive from the Government tax free. The demand curve for labour remains unaltered in the short to term. This will raise employment levels (equilibrium quantity increases).

- (iv) Irrespective of your findings above, the Government decides to proceed with the scheme and finds that 1% of employed workers still lose their jobs each month, but on average, instead of 19% of unemployed persons getting jobs each month, the rate jumps to 49% ceteris paribus. What is the new employment rate in Empland? How long would the 'average' unemployed person now be out of work?
[4 marks]

The market needs to return to equilibrium with the number of employed people leaving jobs equaling the number of unemployed people gaining jobs. So we know that:

$$0.01 \times 100000 \times \text{Employment Rate} = 0.49 \times 100000 \times (1 - \text{Employment Rate})$$

Solving this gives Employment Rate = 0.98 = 98%

Hence the unemployment rate is 2% meaning the average worker is unemployed for about 2 months.

- b. If Australia has a positive unemployment rate (say 5%), then there must be an excess supply of labour. And if there is an excess of labour, wages cannot increase until all workers are employed and the surplus supply is removed. True or False? Explain.
[6 marks]

The statement is false. In the scenario above (before the \$500 gift intervenes) we have a market with constant turnover where it takes time for the two sides of the market to agree on a transaction. In these markets there will always be some goods (ie: labour) for sale that are not yet being used because they have become available only recently.

The key condition for equilibrium in this market is that the number of workers who lose a job each month must equal the number of unemployed workers who get a job. This is necessary for the number of unemployed workers to stay constant, which is required if the unemployment rate is to stay constant. If this were not the case, and say 1% of all employed workers continue to leave their jobs each month, but the economy heats up and many employers are trying to attract new workers (say with a \$500 bonus each month) such that 49% of the unemployed workers now get jobs each month, the unemployment rate would fall to 2% and the average unemployed worker would be out of a job for just 2 months. Because of the competition among employers for new workers, wages are going to rise, hence it is possible for wages to be increasing even when

there are some workers who are unemployed. Wages do go up, and even during a boom, there are always some workers who are unemployed because they are between jobs.

Sample

Economics in Management Practice

Multiple-Choice Answer Sheet

NAME:

INSTRUCTOR:

STUDENT ID:

For each Question, circle the letter corresponding to the answer you believe is most appropriate. Circle only one letter per Question.

Question	Answer			
A1	a	b	c	d
A2	a	b	c	d
A3	a	b	c	d
A4	a	b	c	d
A5	a	b	c	d
A6	a	b	c	d
A7	a	b	c	d
A8	a	b	c	d
A9	a	b	c	d
A10	a	b	c	d
A11	a	b	c	d
A12	a	b	c	d
A13	a	b	c	d
A14	a	b	c	d
A15	a	b	c	d
A16	a	b	c	d
A17	a	b	c	d
A18	a	b	c	d

- End of Paper -

Appendix 2

Assessment cover sheet

Sample

Sample

Assessment Cover Sheet



- GCCM
 GDM
 Executive Year
 MBA
 Hong Kong GDM/MBA

Fill in all details on this form and submit with your assessment

Details

Personal ID <input type="text"/>	Family name <input type="text"/>	Given name(s) <input type="text"/>	
Course name <input type="text"/>	Lecturer/ Instructor name <input type="text"/>	Due date <input type="text"/> / <input type="text"/> / <input type="text"/>	
Assessment name <input type="text"/>	Assessment number <input type="text"/>	Page length <input type="text"/>	

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Signature Date / /

Group assessment items:

This work is the result of collaboration amongst all members of the group listed below and no others. All members of the group have contributed to the assessment.

Family name	Given name	Signature

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Date received <input type="text"/> / <input type="text"/> / <input type="text"/>	Grade <input type="text"/>	Date returned to student <input type="text"/> / <input type="text"/> / <input type="text"/>	Signature <input type="text"/>
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Acknowledgement of receipt of assessment

Student name <input type="text"/>	Course <input type="text"/>	Date received <input type="text"/> / <input type="text"/> / <input type="text"/>
Assessment name <input type="text"/>	Assessment number <input type="text"/>	
Lecturer/Instructor name <input type="text"/>	Signature <input type="text"/>	